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BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES —
ADVANCE NOTICE OF PROPOSED RULEMAKING

REPLY COMMENTS OF THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

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The Burlington Northern and Santa Fe Railway Company ("BNSF") hereby files its reply comments in response to the "Advance Notice of Proposed Rulemaking" ("ANPR") issued by the Surface Transportation Board ("Board") on March 31, 2000.

After a full review of the initial comments filed in this proceeding, BNSF urges the Board to (i) maintain its current policy, mandated by Congress, approving expeditiously mergers[1] that are shown to be in the public interest, (ii) reject all requests to adopt presumptions against mergers in the Board's policy statement, (iii) adopt changes to its regulations that respond to the legitimate concerns of shippers, government agencies and the general public arising from the service crises of the UP/CNW and UP/SP mergers and the CSX and NS division of Conrail, and (iv) reject requests that it reimpose significant economic and other regulation on the railroad industry and, in particular, reject requests that it impose on future merged railroads alone potential "solutions" to industry-wide issues.

BNSF further requests that the Board carefully distinguish between issues and proposals that are, in fact, directly related to mergers and those issues and proposals,

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[1] BNSF will adopt the convention used by most commenters and use the term "merger" to refer to any transaction requiring approval under 49 U.S.C. § 11323 and involving one or more Class I railroads.

raised by the ANPR and the initial comments, that address industry-wide issues, such as "open access" proposals and shortline issues not related to specific rail mergers. This proceeding should address only those issues directly related to mergers, such as merger implementation plans, gateway protection and service guarantees for shippers. All other issues should be separated and addressed, if at all, in separate proceedings.[2]

Finally, BNSF requests the Board to complete promptly its review of any merger-related issues within the 4 to 6 month schedule set forth in Appendix B to BNSF's initial comments in this proceeding, issuing any final rule preferably by October 5, 2000, but in no event later than December 5, 2000.

Many of the initial comments and, indeed, elements of the ANPR itself suggested that mergers will no longer produce benefits for the public, shippers and railroads.[3] This view is fundamentally wrong. Rail mergers, including the proposed combination of BNSF with Canadian National Rail Company ("CN"), can offer meaningful solutions to many of the current issues facing the rail industry. By expanding the reach of single-line service, mergers can offer better, faster, more consistent and responsive service to shippers and the public. By enabling the more efficient use of existing rail resources, mergers can quickly and cost-effectively expand the capacity available to offer improved, competitive service products to shippers, without the need for additional capital investment. By

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[2] The need to distinguish between merger rules and separate proceedings to address concerns for the industry as a whole was also recognized by the Association of American Railroads ("AAR"), National Industrial Transportation League ("NITL"), Consumers United for Rail Equity ("CURE") and others.

[3] *See, e.g.*, Comments of Union Pacific Railroad Company ("UP"), Port Authority of New York and New Jersey ("Port Authority") and Keokuk Junction Railway Co. ("Keokuk").

requiring previously separate organizations to conform to common policies, mergers can reduce the resources required to provide service to shippers and the public and benefit shippers through simplified contacts, transactions and service measures. By creating more efficient enterprises, mergers can enhance the ability of the industry to invest in expanded and necessary infrastructure where required.

BNSF has demonstrated that mergers can produce real benefits for shippers, the public and railroads. As discussed below, the BNSF merger improved service, improved safety, and increased investment in infrastructure. Indeed, if UP's explanations of the origins of its post-merger service meltdown are correct, the merger of UP and Southern Pacific Rail Corporation ("SP") was necessary because only the merged UP/SP could make the necessary investments in facilities that SP had neglected over the years. Despite UP's recent conversion to alliances and cooperative ventures, it is highly unlikely that UP would have made the massive investments contemplated by its service recovery plan on the basis of a mere alliance with SP.

Under the Board's existing policies, as modified by the enhancements suggested by BNSF and others, mergers can achieve salutary benefits while maintaining – and, indeed, improving – service to shippers. Furthermore, future merger benefits will be achieved without adverse competitive effects on shippers, because Board policy requires the preservation of two-carrier competition for those shippers who now benefit from such competition. ***Therefore, the Board should reject all proposals that would establish de facto or de jure barriers to future mergers.*** Any such proposal would violate the Board's obligation to approve a merger "when it finds the transaction is consistent with the public interest." 49 U.S.C. § 11324.

The Board should not be swayed by the comments of UP and other railroads who inflamed shipper sentiment when they responded to the announcement of the BNSF/CN combination by threatening their shippers with responsive mergers that they were not ready or able to pursue. In particular, UP's attack on further mergers is self-serving and designed to protect its current position as the largest North American rail carrier.

UP is the largest rail carrier in the western United States, and it is dominant in carload business. UP also enjoys a distinct competitive advantage today as the largest interchange carrier with both eastern railroads. UP's dominant position would be threatened if transcontinental railroads emerge in the future and, therefore, UP is committed to stopping the development of merged carriers that would subject it to stronger competition. The Board must recognize that UP and the other railroads are not altruistically protecting shippers against repetition of the service failures *they* produced. Instead, they are using the threat of a repetition and expansion of their past failures to protect themselves against the competitive pressures created by the improved services a combined BNSF/CN will provide.

In these reply comments, BNSF will first address several of the larger themes raised in the initial comments filed by others. BNSF will then turn in Appendix A to representative changes proposed to the Board's regulations.

I. <u>GENERAL POLICY ISSUES</u>

The opening comments filed by the many participants in this proceeding raised several general themes, with some parties raising misguided arguments against any future mergers or asking the Board to use its review of general merger policies or specific mergers to force fundamental and inappropriate changes on the entire rail industry.

A. Mergers Can Produce Additional Benefits for the Rail Industry. Some parties – including UP, Port Authority, and Keokuk – argued that the U.S. rail industry has evolved to the point that additional mergers presumptively cannot provide any additional benefits to the public, shippers or the railroad industry.[4/] In a related vein, the U.S. Department of Agriculture ("USDA") stated that "additional efficiencies obtained through the elimination of excess capacity . . . will tend to be limited." And the Port Authority argued that a key problem of the pre-Staggers Act rail industry – excess capacity – has been largely resolved, so that mergers are less likely to be in the public interest. These views are fundamentally mistaken.

The Board's governing statutes require that the Board approve mergers that are in the public interest, and to do so expeditiously. The claim by some parties that mergers can no longer be in the public interest because the industry no longer has excess capacity is incorrect and misguided.

The elimination of excess capacity and rationalization of the rail network is only *one* of *several* factors that can be considered in the public interest balancing process. The public interest benefits of mergers also include improved service for shippers, more efficient use of the Nation's resources, financially healthy railroads and an improved environment.

[4/] "UP questions whether additional Class I consolidations will ever be in the public interest." (Comments of UP at 2); "Today . . . there seems to be no valid reason for applying [the] presumption [that rail consolidations are in the public interest]" (Comments of Port Authority at 4); "[T]here are few if any public interest benefits of mergers. The so-called public interest benefits of mergers are rarely more than empty promises. . . ." (Comments of Keokuk at 6).

Furthermore, railroads continue to have "excess capacity" – *underutilized assets* – in some areas, and mergers can enable railroads to address this issue by building traffic and density over those assets through business provided by new market opportunities and service offerings, by redeploying the assets to better use in other locations, or by allowing retirement of unneeded assets.

In addition, a key issue for the rail industry today is creating additional capacity to meet the future transportation needs of the Nation, an issue raised by Congressman Jerrold Nadler, AAR and other commenters. Mergers can be useful here, as well, because through the more efficient use of existing assets, a merger can create capacity without major investments. The AAR, E.I. DuPont de Nemours and Company and other commenters argued that the Board's policy must ensure that railroads can fund the investments in infrastructure that may be required in the future. A well structured and well implemented merger can produce an entity with an enhanced and improved ability to obtain the capital necessary to invest further in infrastructure, equipment and information technology, when such investments are warranted.[5] Because the public interest also includes enhanced service options for shippers, more efficient use of the Nation's resources, continued investment in rail infrastructure, environmental benefits of increased rail service and other considerations, the efforts of some parties to narrow public interest considerations to excess capacity and rationalization alone are mistaken and contrary to the Board's governing statutes and precedents.

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[5] As discussed below, arguments about the need to raise additional capital run contrary to the requests of many (and often the same) parties who seek to reimpose significant economic regulation on the rail industry.

Despite the claim of some parties, future mergers can offer other significant public benefits. For example, if BNSF and CN are allowed to file their combination application with the Board, they will demonstrate that their proposed combination will produce significant public interest benefits, including:

- Expanded efficient single-line service for many shippers;
- Shipper access to new markets and new service offerings;
- Increased capacity, due to the more efficient utilization of existing resources;
- Increased ability to finance necessary infrastructure, due to both the structure of the combination and the increased profitability of the combined railroads;
- More efficient use of resources; and
- Significant environmental benefits, including those attributable to increases in intermodal traffic.

BNSF and CN will demonstrate that these benefits can be achieved while maintaining the quality of service to shippers and without eliminating effective two-railroad competition for any shipper which currently has such competitive choices.

The benefits that mergers can produce are real, tangible and achievable, as the record of the merged BNSF demonstrates. The merged BNSF significantly improved its safety record, with a 66% reduction in employee days lost due to injury between 1994 and 1999. *See* Statement of Robert D. Krebs, STB Ex Parte 582, at 10 (March 7, 2000) ("*Krebs Statement*"). BNSF also reduced its accidents per train miles by 32 percent. *Id.* at 10 -11. At the same time that BNSF improved its safety record, it became a more efficient system. Its operating expense per 1000 gross ton miles dropped 22% (27% adjusted for inflation). *Id.*

BNSF improved its safety record and became more efficient while improving service for shippers. BNSF improved its on-time performance from about 78% in 1997 to 91% in 1999. *Id.* at 12. At the same time, BNSF's shippers enjoyed substantial rate reductions, with system revenue per ton (adjusted for inflation) down by 20% between 1994 and 1999. Shippers also received the benefit of new service opportunities, as shown by the tremendous growth in BNSF's intermodal traffic and the opening of new markets for grain shippers in the Upper Midwest. *Id.* At the same time, BNSF aggressively competed for traffic using the opportunities it gained in the UP/SP merger, effectively building the revenue equivalent of a new competitive Class I carrier from scratch in three years.

The BNSF merger enabled it to mount an aggressive capital investment program, as BNSF invested over $9 billion in infrastructure improvements, equipment and capacity expansion. *Id.* at 13. The level of spending and the improvements made by BNSF are unprecedented in recent history and are 2.5 times the amount spent by its predecessors in the four years prior to the merger. This aggressive capital spending program included $1.6 billion spent on increased rail capacity, more than $2 billion spent on the acquisition of new locomotives, and improvements made to all BNSF major routes. Shippers have been the direct beneficiaries of this program.

BNSF fully described the *realized* benefits of its merger in "The Burlington Northern and Santa Fe Railway Company's Quarterly Progress Report" filed on January 18, 2000, in Finance Docket No. 32760. In that report, BNSF demonstrated that it has aggressively used the trackage rights it obtained in the UP/SP merger to serve shippers with competitive service offerings, that since the merger it has improved its safety record, that it has improved service to shippers, that it has improved its efficiency, that it has increased investment in infrastructure and equipment, and that it has improved its financial performance.[6] Those who say – egged on by the unfortunate performances of UP, CSX Corporation and CSX Transportation, Inc. ("CSX") and Norfolk Southern Corporation and Norfolk Southern Railway Company ("NS") – that a merger cannot benefit shippers, employees, the public and railroads, should look at BNSF's record.

Therefore, as required by statute, the Board should continue to approve expeditiously, on a case-by-case basis, mergers that can be shown to produce public benefits. The Board should reject as unfounded any claims that the public benefits of mergers have been exhausted.

B. Alliances Cannot Take the Place of Mergers. The Port Authority, USDA, Western Coal Transportation Association ("WCTA"), and other commenters, including some of the railroads who have led the charge against the very idea of a BNSF/CN combination, argued that the Board should now disfavor mergers because many of the benefits of mergers can be obtained through alliances and cooperative ventures. They argued that the merger applicants should be required to demonstrate that the public benefits they claim cannot be achieved through alliances and other cooperative ventures. This argument is wrong.

First, despite broad and unsupported claims to the contrary, the long-term benefits of operating alliances and cooperative ventures remain unproved and untested. The experience of the Burlington Northern and Santa Fe railroads at Avard prior to their merger demonstrates that entities not subject to common control often will not be able to reach

[6] BNSF requests that the *Krebs Statement* and the January 18, 2000 Quarterly Progress Report be included in the record in this proceeding.

agreement even when joint action would be in their mutual interests.[7] As a result, reliance on the promises of alliances alone will mean that potential savings and efficiencies of mergers will often be lost or, at best, will be temporary.

Indeed, mergers provide much stronger incentives to achieve improvements in service and asset utilization. A merged entity has a uniform interest in the maximum profitability of all its assets. In contrast, alliance partners will bring different economic interests to the table, and when entities receive different profit signals from proposed actions, their interests will clash and the optimal course of action, from a systemwide perspective, often will not be pursued. A merged entity will act as a single unit, while an alliance will be subject to the additional costs and inefficiencies associated with negotiating, enforcing and carrying out contracts and operating procedures.

The alliance theory has been championed by railroads who have a competitive interest in stopping the proposed combination of BNSF and CN. Yet, each of these carriers, with the exception of CP, evidently concluded in the recent past that their mergers were preferable to alliances, despite the costs of pursuing a merger before the Board. Furthermore, if alliances actually offer most of the benefits of a merger, these railroads would have pursued such alliances in the past, rather than announcing them only to buttress their assault on the BNSF/CN combination.

There is another major irony in the aggressive promotion by UP and other railroads of alliances. Under the regulations proposed by BNSF, any merger must be accompanied by an operating plan, a meaningful Service Integration Plan, service guarantees, a Safety

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[7] *See* Comments of BNSF at 10; Comments of CN, Statement of Christopher Vellturo, at 87-88.

Implementation Plan, an environmental analysis and an analysis of the ability of the merged railroads to finance any needed improvements in infrastructure. A merger application also must address competition issues and effects on labor. Each element of the merger application then can be tested before the Board by interested parties. In contrast, an alliance, which could raise many of the same operating, service, safety and environmental issues, would proceed without public input or any review by the Board. The Board should be wary when parties argue that alliances can achieve the same long-term goals as mergers, but without any review by the Board.

Second, the benefits of joint purchasing efforts without common control also are overstated. A key benefit of joint purchasing – synergies available through the rationalization of product specifications – often can be achieved only when the cooperating entities are *forced* to adopt common standards, standards which may not be the first choice, or in the specific best interest, of all of the cooperating entities.

Third, mergers enable cost reductions that cannot be achieved otherwise. For example, after the merger BNSF reduced its costs by consolidating various departments, such as law, human resources and public relations. Through clerical consolidation and the elimination of redundant staff positions, BNSF reduced positions in the executive, professional and administrative areas by 27%. As a result of these reductions and other efforts, BNSF was able to increase its gross ton-miles per employee by 46% between 1994 and 1999. These types of staff rationalizations are simply not possible with alliances.

Fourth, to the extent that cooperative alliances involve coordinated operations, they will raise many of the same implementation issues and operational risks as actual mergers. For example, UP claimed that cooperating railroads can provide virtual single-line service through alliances. However, the more that operational coordination is involved, the higher the risk that these "virtual railroads" will face the same problems as merging railroads with respect to the coordination of information technology, the use of common resources such as yards and interchanges and changes in operating patterns. The difference, of course, is that merger partners present these issues to be fully vetted in a public merger proceeding, while "virtual mergers" may proceed without public agency review if implemented via alliances. In short, alliances will raise the same issues as mergers, but *without* public review of the effects on competition, the environment, service and labor.

In fact, alliances and cooperative ventures will raise many of the same issues and risks as actual mergers. Carriers can attempt to create "virtual railroads" by linking themselves together through alliances. However, if these carriers cannot offer better transportation services in the first instance – and that is the Achilles' heel of the railroads – they will not be able to provide truck-competitive service across their interchange points or in joint operations. Furthermore, alliances lack, in the final analysis, the *incentive* and *authority* to enforce decisions that apply on a system-wide basis. A merged railroad can, must and will plan for the optimal use of its entire network.

Fifth, the claim that the Board should favor alliances over mergers – as put forward by, for example, WCTA – presupposes that the Board should make decisions about the preferred organization of business enterprises. However, if a merger can be shown to be in the public interest, the Board should not reject the merger because some of the benefits may be hypothetically attainable through other means.[8]

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[8] Some parties – *see, e.g.*, UP and The Kansas City Southern Railway Company ("KCS") – argued that alliances should be preferred over mergers because they will raise fewer implementation problems. This argument fails on two counts. First, the

Sixth, the position take by Edison Electric Institute ("EEI") and others, that railroad mergers are like mergers in other industries and, therefore, should be reviewed by standards like those used by the Department of Justice and the Federal Trade Commission, is misguided. The analogy between the railroad industry and other industries is misleading because, as discussed below, the Board's policy has been to require that rail mergers not eliminate two-carrier competition for those shippers who are served by multiple railroads before a merger. Furthermore, the nature of a network industry with high fixed costs and low variable costs raises unique issues. Finally, the Board and other regulatory agencies have long recognized that the public interest requires a broad assessment of many issues and factors, not simply antitrust principles.

C. Shippers Are Entitled to Quality Service, Backed by Meaningful Guarantees. One theme clearly emerged from the comments filed by almost all parties, including BNSF, CN and other railroads – the service failures that accompanied the UP/CNW and UP/SP mergers and the NS/CSX division of Conrail's assets cannot be repeated. The parties, including BNSF, also agreed on a general approach to avoid these problems – the filing of detailed Service Integration Plans and the adoption of service guarantees. There were, however, differences in the structural approach to these issues.

BNSF fully agrees with commenters from many interested sectors – shippers, government agencies and producers of shipped goods – that merger applicants should be required to submit a detailed Service Integration Plan that demonstrates their ability to

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operational and information technology problems of coordinated service will arise regardless of the manner in which, for example, single line service is offered. Second, if the proposals of BNSF and others on Service Integration Plans are adopted, the Board will be in a position to assess directly whether service problems are likely to occur.

implement the merger and to respond to any unanticipated problems. To this end, WCTA, the U.S. Department of Transportation ("DOT"), NITL and others proposed very detailed requirements for such plans. However, because the design of a Service Integration Plan will vary from proposed merger to proposed merger, depending upon the nature of the transaction, the Board should specify the *issues* that the Plan must address, rather than attempting to develop a template that all Plans must match.

Service Integration Plans will be more meaningful if merging railroads are required to address, as part of their application, the infrastructure requirements they will face and their ability to obtain the capital necessary to finance that infrastructure. An end-to-end combination of two healthy railroads, like that proposed by BNSF and CN, will have significantly different capital requirements than the acquisition by a healthy railroad of a railroad that has been starved of the capital required to maintain its infrastructure, as in the case of the UP acquisition of SP. An end-to-end combination also will raise fewer issues than the dismemberment of an existing railroad and the division of its assets by two other railroads, as in the division of Conrail between CSX and NS, or the coordination of the lines and facilities of two overlapping carriers, such as UP and SP. Similarly, a merger that involves no significant outlay of cash or assumption of debt will raise different issues than an acquisition that requires major cash outlays. Because of these differences, BNSF proposed in its initial comments that merging carriers provide the Board with information on their needs for capital to finance infrastructure, their ability to obtain such capital, and the effect on their plans of variations from their financial projections. This approach should give the Board, shippers and the public increased confidence in the plans submitted by merging carriers

Because of the CSX/NS bidding war for Conrail's assets, some parties apparently presume that mergers will impair the ability of a merged railroad to make investments in needed infrastructure. However, the experience of the merged BNSF, which dramatically increased its investment in infrastructure, demonstrates that a merged carrier may be able to make investments that neither of the merged carriers could have made independently. Similarly, UP has claimed that its acquisition of SP enabled the combined railroad to reverse the years of underinvestment by SP.

There is now widespread agreement across all industry segments that the Service Integration Plan must also be backed by meaningful guarantees to shippers that service will not deteriorate as a result of the merger. Service guarantees were promoted by railroads (including BNSF), shippers and government agencies in their initial comments. The parties also agreed that service guarantees must include metrics, measuring pre- and post-merger service, that can be used to determine when service problems exist that warrant remedies. Different parties took different approaches to remedies, suggesting no additional remedies, alternate access, relief from contractual obligations, rebates of rates paid, and compensation for all increased costs and any resulting losses.

Because of the complexity of these issues, BNSF believes that the Board should adopt a qualitative approach to this issue, rather than the specific remedy structures offered by some parties. The Board should reject proposals that would establish specific standards for damages or that would override contractual provisions freely negotiated by the parties.[9] Instead, the Board should require that each merger application include a program of service

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[9] *See, e.g.*, Subscribing Coal Shippers ("SCS"), Oklahoma Gas and Electric, and EEI.

guarantees. The Board should review the proposed guarantees and the public comments on their adequacy, as part of its overall evaluation of the transaction. The Board should not prescribe the form that guarantees must take, including the nature and extent of the remedies available to shippers. In a regulatory structure dominated by private contracts, the Board cannot, in essence, rewrite only one provision of extremely complicated business transactions.[10]

If BNSF and CN are allowed to file their merger application, they will describe in their application the fundamental aspects of a service guarantee package, including remedies (including alternate access, when necessary), and efficient mechanisms for resolving disputes during the three-year implementation period for their merger, if approved. This package will provide shippers with meaningful assurances that the combined BNSF/CN will perform up to its service promises and meaningful relief in the highly unlikely event that, in isolated cases, the combined BNSF/CN fails to do so.

D. Merger Applicants Should Not Be Required to "Enhance" Competition. The initial comments revealed a clear division over the role that competitive issues should play in the Board's review of mergers. Many parties – including USDA, Western Canadian Shippers' Coalition, New Jersey Transit, and The Chemical Manufacturers' Association and American Plastics Council – argued that the Board should use mergers as an opportunity

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[10] BNSF's position is supported by DOT, which recommended "that applicants and shipper groups . . . be strongly encouraged to enter into contractual agreements that guarantee minimum levels of service during the post-merger transition period. . . . The details of the service guarantee could be worked out between the applicants and the individual shippers and shipper groups, and should be tailored to fit specific merger cases." Comments of DOT at 9.

to expand the rail options available to shippers, conditioning mergers on open access, terminal switching or similar arrangements.

The Board should *not* amend its regulations or policies to require that mergers *increase* competitive options. As a practical matter, such a policy would adversely change the economics of many transactions, effectively resulting in the denial of significant benefits to the public, without enhancing competition or service for shippers. For example, assume that a proposed merger would provide continuing public benefits of $500 million per year and, through appropriate conditions, maintain competitive options for all 2-to-1 shippers.[11] If the Board approved that merger, public benefits would be realized and all affected shippers would retain competitive options. On the other hand, if the Board required the merged railroads alone to provide "bottleneck" relief for all shippers, as some parties proposed in their initial comments, the merger could very well founder. In that case, the $500 million per year of public benefits would be lost and the pre-merger competitive status quo would be maintained. This result could not be in the public interest.

Therefore, the Board should reject requests that mergers only be approved if they include conditions designed to "enhance" competition. This approach could, as shown above, result in the loss of benefits to the public if it effectively prevented beneficial mergers from going forward. The imposition of competition-enhancing conditions, including the removal of "paper barriers" with respect to shortlines, would unfairly burden merging railroads with a loss of revenue that would threaten the viability of many transactions. The

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[11] Of course, under governing precedent, any 3-to-2 shipper could argue that its circumstances require remediation.

retroactive imposition of these conditions on existing mergers would raise similar problems, including significant legal questions.

E The Board Should Review Only Concrete and Specified Downstream Effects. Several parties argued that the Board should review the "downstream" effects of any merger, including any *potential* responses by other carriers. For example, UP argued that merger applicants should address, as an abstract matter, whether a system of two transcontinental railroads would be in the public interest. The American Association of Port Authorities argued that merger applicants should address the likely strategic responses of other railroads. In addition, DOT argued that the applicants should demonstrate why their proposed merger would produce better results than other hypothetical pairings.[12]

In its initial comments, BNSF agreed that the Board should review concrete downstream effects, which it defined as (i) any potential export by the merging railroads of their service problems to other railroads, and (ii) any new service and competition issues raised by actual subsequent merger proposals, announced by a specified date. BNSF agreed that concrete transactions, if timely announced, should be reviewed, but that purely hypothetical transactions should not and could not be considered.

First, the Board should not presume that the BNSF/CN merger would lead inevitably to responsive mergers, certainly not in the short run. Despite the overheated rhetoric of several Class I railroads that they will be forced into responsive transactions, they will respond to the BNSF/CN combination only if that combination increases the competitive pressure the carriers face. That increase in competition would be a good thing.

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[12] *See also* the comments of DOT, NITL, The Dow Chemical Company ("Dow"), Procter and Gamble, and PPG Industries ("PPG").

Second, some Class I carriers threaten that they will pursue responsive mergers even if they have not yet resolved their current service problems. Of course, any merger should be judged on its own merits, not based on the threats of others. Furthermore, nothing requires the Board to approve a "responsive" merger if the applicants cannot satisfactorily address their existing service issues.

Third, because other Class I carriers have argued, quite strongly, that they can achieve the benefits of a merger through alliances and cooperative ventures, they may elect to use such alliances and ventures as the vehicles for any response to a merged BNSF/CN. Finally, despite the requests that the Board require merger applicants to analyze subsequent merger *possibilities*, it would be impossible for any merging railroads to forecast accurately the timing, nature and strategy of such responsive mergers. In contrast, the BNSF proposal would require the merger applicants to address specific issues raised by a specific "responsive" merger.

F. The Board Should Maintain Its Existing Presumptions on Merger Economic Issues. In recent merger proceedings, the Board has required that railroads remedy any loss of competition for 2-to-1 shippers. The Board has concluded that competitive issues are generally *not* raised by 3-to-2 shippers and that the "one lump" theory is valid, with both issues subject to review under specific circumstances presented in individual merger transactions. However, the Alliance of Automobile Manufacturers, EEI and others requested that the Board find that all 3-to-2 situations raise competitive issues; and Dow, Certain Coal Shippers ("CCS"), Glass Producers and others asked the Board to reverse its position on the one lump theory. The Board should not change its approach to these issues.

BNSF agrees with Ameren Corporation and NS that any merger application should contain a commitment to remedy any resulting 2-to-1 situations.[13] Given its past review of this issue and the limited number of 3-to-2 shippers left, a factor mentioned by DOT and NITL, the Board should continue its present course of presuming that 3-to-2 cases do not raise competitive issues, subject, of course, to review of any claims by specific 3-to-2 shippers that the pending merger would, in fact, result in a loss of competitive pressure on the rates and services they provide. The same is equally true for one lump theory cases, where the Board should remain receptive to any specific complaints, but not create a new presumption for merging railroads to overcome.

G. The Board Should Not Expand Labor Protection. Several commenters – including the Rail Labor Division, Transportation Trades Department, AFL-CIO and DOT – requested that the Board eliminate use of cram down powers, extend the *New York Dock* protections provided union members and take additional steps to expand the already extensive protections that railroad employees receive.

BNSF and CN have committed, as part of their combination, to attempt to resolve all labor issues through negotiations with the affected unions, and they have made concrete progress in this area. However, the Board cannot administratively eliminate the contract override provisions of the statute, and no comments demonstrated any reason why the

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[13] The application should contain the *commitment*, because the remedy, often dependent upon the willingness of other railroads to serve a shipper, may not be available when the application is filed if other railroads oppose the merger. Indeed, opposing railroads could *refuse* to negotiate solutions for 2-to-1 shippers precisely to torpedo the merger. These same railroads will be more willing to negotiate if the merger were approved, subject to conditions, and they see revenue opportunities.

Board should expand the already generous *New York Dock* provisions. Of course, these existing protections would not apply if railroads pursued alliances, rather than mergers.

H. The Board Should Not Expand Its Consideration of Cross-Border Issues. Several commenters expressed concerns about the cross-border issues raised by combinations such as the proposed BNSF/CN transaction. For example, UP argued that a cross-border merger application should include an operating plan that addresses the entire system; and the U.S. Department of Defense ("DOD"), North Dakota Public Service Commission, Grain Dealers Association, Wheat Commission, and Barley Council and others expressed concern that a cross-border railroad would favor foreign shippers or divert traffic to foreign ports. DOD also questioned whether a cross-border railroad would be willing or able to meet the defense requirements of the United States.

BNSF addressed many of these issues in its initial comments, as did other parties. BNSF noted that NAFTA and WTO both prohibited certain types of national favoritism and provided specific and tested mechanisms for resolving disputes. With respect to defense issues, BNSF noted the history of U.S.-Canadian cooperation on defense matters and in other key areas.

Nonetheless, BNSF recognizes that some parties, including DOT, have expressed concerns for which the best answer would be a more organized presentation. Therefore, BNSF agrees that merger applicants should address these issues as part of an integrated operating plan and also should address the specific legal issues raised by DOT in its initial comments as they apply to any given transaction.

I. The Board Should Require That Merger Applicants Commit to Maintain Major Open Gateways. Several commenters, such as the National Grain and Feed Association ("NGFA"), NITL, and Shell Chemical Company, expressed the fear that future mergers would lead to the closure of existing gateways, reducing the options available to shippers and leading to inefficient use of the national rail system. In its initial comments, BNSF proposed that all merger applications contain a commitment to maintain existing major gateways, both physically and economically. However, BNSF cautioned against the adoption of rigid guidelines governing such gateways, such as those proposed by NGFA, noting the problems that arose from the rigid *DT&I* conditions of the past.

Therefore, BNSF agrees that the Board should amend its regulations to require that merging railroads include in their application a proposal for identifying major open gateways, a commitment to maintain as open such gateways and a specific proposal for establishing the rates that apply to such gateways. The Board would then consider the proposal and any public response as part of its public interest determination.

J. The Board Should Consider Issues of Nation-Wide Application in Separate Proceedings. Many commenters requested that the Board adopt fundamental changes to the regulation of rail carriers. Parties raised issues concerning shortline railroads,[14] open access,[15] bottlenecks[16] and many other issues.

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[14] *See, e.g.*, DOT, DOD, Farmrail System, Inc., PPG and American Short Line and Regional Railroad Association.

[15] *See, e.g.*, United Transportation Union, WCTA, McKinley Paper Company and Montana Wheat & Barley Committee, et al.

[16] *See, e.g.*, Canadian Pulp and Paper, CCS, CURE and Procter and Gamble.

BNSF again urges the Board to separate those issues that arise directly from specific merger proceedings from those that should only be addressed on a nation-wide basis. Issues that are not directly related to mergers should be addressed separately from merger issues, and changes in the Board's policies, if any, should be applied to all carriers uniformly and without bias against future merger partners. For example, shortline railroads and others have requested that the Board eliminate all paper and steel barriers; these issues are not merger related and should be addressed separately. Other parties, such as CCS, have requested that the Board expand "bottleneck" relief beyond the current limited contract exception. Again, this issue is not directly raised by mergers, and the parties making these proposals want relief that extends beyond mergers. Therefore, the Board should take action, if any, only after considering in a separate proceeding the national implications of such proposals.

II. SPECIFIC PROPOSALS

In Appendix A, BNSF will respond specifically to some of the regulatory revisions proposed by specific parties. (Because many parties raised similar issues, BNSF will address representative comments, rather than every proposal.) BNSF's comments will reflect the general principles set forth in Part I of these reply comments.

III. CONCLUSION

The Board should continue to approve expeditiously mergers that are shown to be in the public interest. Mergers can be a means for providing shippers with improved and expanded service and for using the Nation's resources more efficiently. The Board should not change its proven approach merely because a merger is either cross-border or transcontinental. The Board also should not encourage carriers to enter into less efficient or transitory alliances or require applicants to address purely hypothetical issues, such as the structure of alliances that do not exist or the effects of subsequent mergers that have not been proposed and may never occur.

The Board should take affirmative steps to address the service-related concerns of shippers. These steps should include a requirement that any merger application include both a Service Integration Plan, demonstrating that the merger applicants have a well-structured and adequate plan to implement their merger integration, and service guarantees, demonstrating that shippers will be compensated if transient service problems nevertheless develop.

The Board should not alter its approach to the economic issues that provided the foundation of the rail industry's progress in the post-Staggers Act period. In particular, open access could threaten the ability of the rail industry to finance the infrastructure and service improvements all sectors of the industry desire. Furthermore, it would be inappropriate and counterproductive to impose fundamental changes in regulation only upon new mergers, rather than on a nation-wide basis.

Finally, the Board should consider merger-related issues separately from other issues and on an expedited basis. Following the schedule set forth in Appendix B to

BNSF's initial comments, the Board should issue a final rule on merger-related issues within 4 to 6 months of receiving reply comments.

Respectfully submitted,

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APPENDIX A TO THE REPLY COMMENTS OF BNSF

DISCUSSION OF PROPOSED REVISIONS TO THE BOARD'S MERGER REGULATIONS

A. Government Agencies and Port Authorities

U.S. Department of Transportation ("DOT"). DOT's comments contained an extensive array of proposals, many of which BNSF supports, although in slightly different formulations.

(i) Merger-Related Service Standards. DOT proposed that merger applications contain: base period metrics; a commitment to work with a post-merger Service Council; a transitional service plan; contingency plans for service breakdowns; service guarantees and remedies; staged implementation plans, with a provision, in some cases, for Board approval for each step; and a review of prior merger service records of the merger applicants.

BNSF agrees with the basic direction of DOT's proposal. For example, BNSF will file, as part of its combination application with CN, a Service Integration Plan that will address contingency planning and will be based on a staged implementation process. As noted above, BNSF also agrees that performance metrics and guarantees should be part of each application, although it believes that the structure of the metrics and guarantees should be specific to each case. Finally, while BNSF agrees that mergers should proceed on a phased basis, it does not believe that it would be efficient or practical to obtain Board approval for each phase of the implementation of a merger.

(ii) Merger-Related Competition Issues. DOT proposed that merged railroads maintain open gateways and provide open switching to exclusively served shippers in terminal areas. DOT stated that "bottleneck" issues should be pursued only after full debate of the implications of any change in policy, and it noted that the 3-to-2 issue is essentially moot and, therefore, can be pursued on a case-by-case basis.

BNSF agrees fully with DOT on the 3-to-2 issue. BNSF set forth a specific open gateway proposal in its initial comments. BNSF would object to any imposition of "bottleneck" relief on merging carriers alone, because such a policy would have a significant negative effect on the economic benefits of the proposed merger and, in the long run, on the ability of the industry to meet many of the other goals favored by DOT, including infrastructure investment.

(iii) Merger-Related Financial Issues. DOT requested that there be closer review of the pro forma financials submitted with a merger application, that the Board review the effect of the merger on shipping rates and the ability of the merging railroads to raise capital, and that the Board require a sensitivity analysis, analyzing the effect if the merging railroads do not achieve all their profit goals.

DOT's proposals are very similar to a proposed regulation set forth in BNSF's initial comments, and, if BNSF and CN are allowed to file their control application, that application will address DOT's principal concerns.

(iv) Merger-Related Passenger Issues. DOT asked that the Board consider the effect of mergers on passenger rail service. BNSF agrees that these issues should be addressed in both the Operating Plan and the Service Integration Plan submitted by merger applicants.

(v) Shortline Issues. DOT believes that service guarantees should be extended to Class II and III railroads and that the Board should review "paper barriers." For reasons set forth in its initial comments, BNSF does not agree that the Board should review the contractual provisions under which Class I carriers transferred assets to shortline railroads, nor should the Board reopen these private contractual agreements, which were generally premised on economic terms that took into account the so-called "paper barriers" now complained of.

BNSF agrees with DOT to the extent that *customers* of shortline railroads should be included in the merging railroads' service guarantees; however, these guarantees can be extended only so far as the merging railroads control the service. BNSF and CN will offer their shippers specific and meaningful service guarantees. However, service guarantees should be directed at providing compensation only for those customers who *purchase* service from merging carriers.

(vi) Labor Issues. DOT argued that the Board should eliminate or strictly restrict the use of the contract override provision of the statute in the context of labor relations, expand the use of separation allowances for employees offered relocation, and consider requiring the completion of implementing agreements before any merger. BNSF is strongly committed to the consensual resolution of all labor issues, but it does not believe that it is appropriate to eliminate or restrict the availability of the contract override provision. Furthermore, the implementation of restructured labor agreements should not hold up a merger, because such a delay could result in the loss of significant public benefits. Of course, BNSF recognizes the value of encouraging the resolution of the maximum number of labor issues before any merger is implemented.

(vii) Environmental Issues. DOT suggested the use of community partnerships to address issues that do not rise to the levels calling for mitigation under current STB rules, an analysis of the infrastructure required to implement merger-related and future growth and detailed plans to avoid blocked crossings. BNSF agrees that all merger-related effects should be addressed as part of the environmental analysis of the application, and BNSF intends to work with local communities to address their concerns about the BNSF/CN transaction, including the potential for blocked crossings.

(viii) International Issues. DOT stated that cross-border safety issues should be addressed, as well as the potential for national favoritism, the ramifications of foreign law, and the potential effect on national defense of the United States. BNSF will address cross-border safety issues in its application and would not object to codification of this requirement. While BNSF does not believe that these issues should be of major concern in a transaction with Canada, a long-time defense and trading partner of the United States, BNSF is willing to have merger applicants be required to discuss these issues in their application.

(ix) Downstream Issues. DOT suggested that any applicants should address "why their combination offers benefits that would not be generated by a merger of either with [sic] a different parent, or poses fewer risks than another combination." BNSF disagrees with this formulation, because it would require unfounded and untestable speculation. The test of any merger should be whether *it* produces public benefits, not whether other combinations – combinations to which no party has agreed and might never occur – could also produce benefits.

U.S. Department of Defense ("DOD"). DOD raised several issues concerning the effects on national defense of cross-border transactions. Many of these issues were also raised by DOT, so BNSF will not repeat its analysis of those concerns. DOD also raised other issues addressed by other parties, such as the adequacy of service, enhancement of competition and downstream effects.

BNSF does not believe that defense concerns can arise from a merger with a railroad in Canada, one of most important commercial and *defense* treaty partners of the United States. Nonetheless, BNSF certainly agrees that the Board should be responsive to any merger-related issue raised by the DOD, and BNSF will, of course, cooperate with DOD to address any of its concrete concerns.

U.S. Department of Agriculture ("USDA"). USDA proposed several changes to the Board's merger regulations. First, USDA suggested that the Board address all possible downstream and crossover effects of mergers on the rail industry, other railroads, other transportation modes, shippers and communities, and focus on the overall effect on the entire transportation system, rather than upon the merged system itself. BNSF believes that the Board's regulations, particularly if amended as suggested by BNSF, will address the legitimate concerns raised by USDA, such as the preservation of competition, the preservation of essential services and the preservation of adequate service by the merging railroads.

Second, USDA suggested that the Board require that merging railroads prove the public benefits of any consolidation and that those benefits cannot be achieved by means short of a merger. Merger applicants are, of course, already required to provide support for their claims of public benefits. BNSF has addressed in Part I arguments about other mechanisms to achieve public benefits, short of mergers. BNSF notes here that USDA's other concerns are more easily addressed in a formal merger proceeding than they would be if railroads enter into a series of nonjurisdictional alliances.

Third, USDA suggested that merging railroads indemnify shippers and others for costs incurred due to merger-related service interruptions and submit all such claims to binding arbitration. BNSF has made specific proposals on the structure of service guarantees, but believes that any compensation should be limited to customers.

Fourth, USDA requested that the Board consider the ability of the merged firm to make the necessary investments in infrastructure. In its initial comments, BNSF made a parallel, but not identical proposal.

Fifth, USDA asked the Board to require that merger applicants offer specific proposals to enhance competition and to mitigate any adverse competitive consequences of the merger on shippers. BNSF agrees that 2-to-1 shippers should be provided competitive alternatives to prevent the loss of existing two-carrier competition. While BNSF objects to any wholesale shift in the current policy on 3-to-2 shippers, BNSF notes that the Board has always been willing to entertain specific issues raised by a 3-to-2 shipper. Finally, for reasons set forth in its initial comments and above, BNSF continues to object to any proposal that would require merger applicants to enhance, rather than maintain, competition, such as expanding the Board's setting of bottleneck rates.

Sixth, USDA requested that the Board require merger applicants to keep all existing gateways open and to open those gateways that were closed in the past. BNSF has made a specific proposal with respect to existing gateways. As to previously closed gateways, BNSF believes that the proper goal of the Board's merger policy is to *maintain* existing competition with respect to a particular merger. Issues like previously closed gateways should be considered, if at all, on a national basis. Indeed, BNSF, along with other carriers, believes that meaningful service improvements can occur when railroads achieve greater concentration of traffic operating on runthrough trains, through fewer – not more – interchanges.

Seventh, USDA requested that the Board consider the effects of future major railroad consolidations upon shortlines and regional railroads. While BNSF does not believe that the Board should protect individual carriers (rather than competition), it agrees that the effects on service provided to *shippers* located on shortlines and regional railroads are appropriate issues to be considered by the Board.

Eighth, USDA asked the Board to review transnational mergers to ensure that shippers in both countries receive fair and equal treatment. As indicated in its comments on DOT's proposal, BNSF understands that any cross-border merger must address this important issue; however, BNSF also believes that many cross-border shipping issues relate to questions of claimed national subsidies of the underlying product (*e.g.*, lumber), and not to the transportation of that product. BNSF submits that transportation policy should remain neutral with respect to cross-border trade disputes.

Ports of Seattle, Tacoma and Everett ("Ports"). The Ports proposed changes to the Board's regulations that would require, in essence, that the Board not approve any rail merger unless, after the merger, all shippers have access to more than one Class I carrier. This rule would apply to both local access areas and all routes between major market areas. The Ports also argued that all paper barriers applicable to shortline railroads should be eliminated as a condition to any merger.

As discussed in BNSF's initial comments and above, the Ports' open access conditions address issues that should be considered in a context broader than mergers. There is no sound reason for applying such conditions only to merging railroads. Furthermore, the proposal, if applied only to merging railroads, would undoubtedly prevent some mergers from going forward, thereby eliminating public benefits that could be achieved without adverse competitive effects on shippers. BNSF also has demonstrated that shortline railroad issues should be addressed, if at all, on an industry-wide basis.

Port Authority of New York and New Jersey ("Port Authority"). The Port Authority proposed significant changes to Section 1180.1(a) that suggest that future rail mergers would limit competition and reduce the adequacy of rail service, favor only those rail consolidations that would enhance competition and improve rail service, and require that any benefits of a merger not be achievable through other means.

Each of these premises is incorrect, as BNSF has discussed above. First, given the Board's 2-to-1 policy, future mergers will preserve competition and should enhance service. Second, the enhancement of competition is not an appropriate merger condition, but instead raises issues that should be addressed, if at all, on a nation-wide basis. Third, the Board should not presume that the benefits of mergers can be achieved through other means – while some benefits may be so achievable, there are limits on voluntary cooperation that have been observed in the rail industry and elsewhere.

Second, the Port Authority proposed significant changes in Section 1180.1(c). These changes would (a) eliminate from consideration benefits of a merger that would accrue to the carriers, without causing adverse effects on shippers, (b) limit public benefits to those that cannot be achieved by other means, (c) establish a presumption against any transaction that reduces competitive alternatives, even if adequate competition would exist on a post-merger basis, and (d) presume that any reduction in capacity will result in a harm to essential services. BNSF has already addressed items (a), (b) and (c). As to (d), while BNSF agrees that the reduction of excess capacity is not the major industry issue today, the Board should not erect presumptions that could prevent continued rationalization or increased and enhanced use of existing facilities or achievement of other potential benefits of mergers throughout the country.

Third, the Port Authority requested that the Board add a new section to its regulations, addressing downstream effects. The proposed language would require that the Board give the same weight to any harm to the public benefit arising from such a response as it gives to harm resulting from the proposed consolidation. BNSF strongly objects to this proposal. If the first merger would preserve competition and produce public benefits, it should be approved. If subsequent transactions would create public harms, the Board should address those harms directly, including but not limited to rejecting such transactions.

Fourth, the Port Authority proposed changes to existing Section 1180.1(d); these changes would allow the Board to condition mergers to enhance competition and to address public injury arising from downstream effects. BNSF has already discussed why such changes in current Board policy are inappropriate and would be harmful to the rail industry. The Port Authority also would eliminate existing provisions that define the proper scope of conditions imposed in a merger. However, these limitations remain both valid and essential.

B. Shipper Groups

Chemical Manufacturers Association and American Plastics Association ("CMA-APC"). While addressing all of the issues raised by the ANPR, the CMA-APC proposed regulatory language on one issue, enhancing competition. CMA-APC proposed an Access Condition, under which every shipper served by the merged carriers would have the right to receive service from at least one rail carrier other than the merged carriers and their affiliates.

BNSF continues to believe that the appropriate standard of review, from both a legal and economic perspective, should be the prevention of competitive harm to shippers *caused* by a merger. The CMA-APC Access Condition would go well beyond preventing such harm. Any move to a system of partial or full open access deemed necessary and appropriate should be considered and implemented on an industry wide basis, and not limited to merging carriers.

National Mining Association ("NMA"). NMA proposed two changes to the Board's regulations. First, it suggested that the effect of a merger on transportation alternatives be expanded to include commodity producers and consignees as well as shippers. BNSF agrees that commodity producers have an important stake in the health of the rail industry. However, the Board must recognize that, given the contract basis of much traffic, only the shipper will be in a position to address many service issues.

Second, NMA proposed, without discussion, eliminating the current provision of Section 1180.1(a) that recognizes that some combinations that reduce transport alternatives to some shippers may still be in the public interest because of their substantial and demonstrable benefits. While BNSF is committed to obtaining an alternative for any

2-to-1 shipper, such relief for 3-to-2 shippers, or others with shipping alternatives, is not generally necessary to maintain competitive pressures on pricing.

Third, NMA proposed that the Board include in its regulations consideration of whether a proposed transaction would diminish the quality of service to shippers and others, as measured by performance criteria established by the Board. BNSF has specifically proposed that any merger application include service guarantees and the metrics upon which such guarantees would be based.

Edison Electric Institute ("EEI"). EEI proposed extensive changes to Section 1180.1(c)(2)(i), designed to change significantly the standards the Board applies to mergers. EEI proposed that, in any merger, the Board will (i) not permit applicants to close gateways, (ii) consider 3-to-2 situations as competitive losses, (iii) consider evidence on the one-lump theory, (iv) consider the necessity for new bottleneck standards, (v) consider establishing a single, competitive switching rate within a terminal area, (vi) consider whether any premium over book value or market value, or the acquisition itself, might cause shippers to be exposed to a risk of rate increases or loss of adequate service, (vii) consider whether well-defined service performance guarantees should be required, and (viii) consider whether paper barriers and steel barriers of the applicant carriers should be eliminated.

BNSF has made parallel proposals with respect to gateways, service guarantees, and analysis of the effect of the proposed merger on service. BNSF also agrees that any consideration of the one-lump theory should take place in the context of specific facts, rather than in a rulemaking. However, for the reasons set forth above, BNSF believes that EEI's other proposals go well beyond the issues directly raised by a merger application.

Subscribing Coal Shippers ("SCS"). SCS proposed several major changes to the Board's regulations.

First, SCS proposed regulatory language that would require the merged railroads to make any shipper financially whole for any injuries a shipper incurs as a result of post-consolidation service problems. The proposed language would override any limits on liability contained in any contracts and would apply to all major consolidations approved on or after January 1, 1996.

The Board should not dictate the terms of any service guarantees, but instead should consider the adequacy of the guarantees offered by the merger applicants. Furthermore, it would severely undermine the industry's reliance on contracts if shippers could override one provision in a contract that is intended to define the entire commercial relationship between the parties.

Second, SCS proposed changes to the Board's regulations that would require merging railroads to offer competitive access to other carriers. Competitive access should be considered as a nation-wide issue, rather than an issue limited only to future mergers.

Third, SCS requested that the Board amend its regulations to require merging carriers to offer bottleneck rates. BNSF addressed this issue extensively in its initial comments. In short, BNSF believes that any extension of bottleneck rates beyond the current contract exception would be unwise and harmful to railroads and shippers generally.

Fourth, SCS proposed that, after Board approval of a merger, any person could petition for the removal of any paper barriers applicable to shortline railroads. Furthermore, the SCS proposed that the Board find that paper barriers are inherently anti-competitive and that the Board adopt rebuttable presumptions that paper barriers are unreasonable. Again, BNSF does not believe that the Board should override the commercial arrangements that parties have negotiated.

Fifth, SCS proposed that any premium paid for a carrier's assets and costs associated with rail premium service be excluded from the carrier's cost of service. The Board has considered this issue only in the past month, and there is no need for it to revisit the issue.[17]

Committee to Improve American Coal Transportation ("IMPACT"). IMPACT proposed extensive changes to the Board's regulations.

First, IMPACT argued that each merger application should include concrete and enforceable service assurances. In its initial comments, BNSF proposed a similar addition to the Board's regulations.

Second, IMPACT stated the Board must consider any downstream effects, including future mergers, and that any merger application must address the competitive and public interest implications of such downstream effects. BNSF has proposed that downstream effects be limited to (i) the export of service problems by the merging railroads, and (ii) the potential effects of any subsequent merger announced by a date certain. However, the Board should not impose conditions on the first merger that are designed to remedy problems created by the subsequent merger.

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[17] *FMC Wyoming Corp. and FMC Corp. v. Union Pac. R.R.*, STB Docket No. 42022 and Rail General Exemption Authority – Petition of AAR to Exempt Rail Transportation of Selected Commodity Groups – Petition for Partial Revocation of Exemption for Coke (STB served May 12, 2000); *Western Coal Traffic League v. Union Pac. R.R.*, STB Finance Docket No. 33726 (STB served May 12, 2000).

Third, IMPACT proposed a three-year "cooling off" period between Class I mergers, although this moratorium could be waived by the Board. Such a "cooling off" period would violate the statutory deadlines imposed on the Board by Congress. Furthermore, because the IMPACT proposal would not apply to subsequent mergers filed within the time allowed for responsive applications, IMPACT's proposal would have the perverse effect of encouraging the premature negotiation and pursuit of mergers.[18]

Fourth, IMPACT proposed that the Board amend its regulations so that 3-to-2 situations would be presumed to have an anticompetitive effect. The Board has considered this issue in recent years, and it should maintain its current policy of allowing individual shippers to pursue any claims that a 3-to-2 situation would result in an actual loss of competitive pressure for the shipper.

Fifth, IMPACT proposed that the Board abandon the one lump theory. As discussed in BNSF's initial comments, the validity of the one lump theory is best reviewed in the context of specific transactions, rather than through the rulemaking process.

Sixth, IMPACT proposed that divestiture be used as the primary remedy to respond to competitive issues raised by mergers. IMPACT has offered no persuasive reason why divestiture, rather than trackage rights, is a preferable remedy or why the issue should not be addressed on a case-by-case basis.

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[18] The pressure to rush to produce a premature merger application, rather than face being barred for three years or forever, is qualitatively different from the pressure UP and other Class I railroads claim they would face to merge in response to a BNSF-CN merger application. As long as there are no artificial deadlines, there is no reason for competing railroads to propose any action before it makes economic sense for them to act on it.

Finally, IMPACT made clear its desire that merger conditions be used to enhance competition, not just to preserve competitive options that would be lost by a shipper due to a merger. These issues should be considered and pursued, if at all, on a nation-wide basis.

The National Industrial Transportation League ("NITL"). NITL proposed several significant changes to the Board's regulations governing consolidations, although it did not offer specific regulatory language. BNSF and NITL are in agreement on the general approach to some issues, but BNSF disagrees with those NITL proposals, in particular, that could effectively require the Board to disapprove mergers that do not enhance competition or that would impose upon newly-merging carriers alone solutions to industry-wide issues.

On the "agreement" side, BNSF has proposed specific regulatory changes that would address several issues raised by NITL, including the consideration of downstream effects, the maintenance of major existing open gateways, the submission of detailed service integration plans, and the submission of system-wide operating plans in cross-border mergers.

However, several changes proposed by NITL are inappropriate. First, NITL proposed that the Board shift the burden of proof on the one lump theory to applicants. There is no reason for the Board to reconsider this issue on a generic basis; the specific application of this principle to individual shippers is best addressed in the detailed factual context of a specific merger.

NITL also proposed that the Board review the public benefits claimed by merger applicants in prior merger proceedings in order to evaluate the credibility of current claims. BNSF agrees that a review of past mergers is appropriate. However, because economic conditions change so much over time, the focus should be turned, instead, to the demonstrated ability of the merger applicants to implement their prior mergers smoothly and to recover quickly from any merger-related service difficulties.

NITL also proposed that the Board revise completely its approach to reciprocal switching, allowing reciprocal switching within a specified distance of a terminal, with the fee determined by arbitration in the absence of agreement among the carriers. Open-ended reciprocal switching is an industry-wide issue, not one appropriately addressed in the context of a particular merger proposal.

NITL also proposed revisions to the Board's bottleneck rules. As noted in its initial comments, BNSF does not believe that bottleneck relief should be extended beyond the current contract extension.

NITL proposed revisions to the Board's regulations that would address merger premium and shortline railroad issues. BNSF already has addressed parallel proposals and will not repeat that discussion.

C. Class I Railroads

Union Pacific Railroad Company ("UP"). UP continued its apparent attacks on any further mergers. BNSF has discussed UP's major themes – including the claim that mergers should only address excess capacity – in its initial comments and in Part I of these comments. UP also proposed that the Board require any future merger application to address the effects on competition and the public interest of combining all Class I railroads in the U.S. and Canada into only two railroads. BNSF strongly objects to this proposal. It would be impossible for any applicant to address the speculative ramifications of proposals that no one has yet made or, indeed, may ever make. Furthermore, the competitive and operational issues raised by future mergers will be specific to transactions, rather than generic in nature. Indeed, based on UP's comment on the diminishing benefits of future mergers and the attractions of alliances and its recent announcement of the Arzoon alliance, it would appear that UP believes that it, and by extension the entire rail industry, should follow a different course in the future.

UP proposed a regulation that would, in essence, define the details of a Service Integration Plan, establish specific benchmarks for shipper service guarantees, and define the triggers and remedies for service failures. As BNSF has discussed and as UP believed during its service crisis, these issues must be addressed on a transaction-specific basis.

UP proposed a specific regulation on open gateways. BNSF has proposed that merger applicants maintain existing major open gateways. However, the Board should adopt a more general statement of policy, rather than the detailed methodology proposed by UP, so that merging railroads would retain the flexibility to respond to particular challenges presented in their particular cases.

UP proposed a regulation that would require the Board to consider as public benefits only those benefits that could not be achieved through other means, such as alliances, and to consider as well whether any benefits that could be achieved absent the merger would be foreclosed by the merger. As discussed above, alliances and cooperative partnerships are not as efficient or as dependable as mergers, and they are likely to be temporary. Foregoing the benefits of a merger on the premise that the benefits of an alliance or cooperative partnership will be equally productive or enduring has yet to be demonstrated in the rail industry. Furthermore, it would, of course, be impossible to predict with any reasonable certainty which public benefits could be achieved absent a merger, as it would require a forecast of whether carriers would cooperate in a variety of ways absent the impetus provided by common management. This approach also would require the Board, for example, to determine the *bona fides* of any promises of cooperation made by UP in order to defeat the proposed BNSF/CN combination. Similarly, there could be no basis for speculating what "benefits" of, for example, BNSF cooperation with CP would be lost if BNSF and CN combined. In short, UP has proposed a test that would be meaningless in practice and that is designed to prevent any future mergers, especially those involving BNSF.

UP proposed a regulation that would require an analysis, in any cross-border combination, of the effects of the combination on foreign competition, operations and finances. The BNSF/CN combination application will contain an operating plan that addresses the entire system and financials calculated on a consolidated basis. Canadian competition issues will be addressed in submissions to the Canadian agencies who have authority to review the BNSF/CN combination.

CSX Corporation and CSX Transportation, Inc. ("CSX"). BNSF agrees, with some difference in details, with the premise of many of CSX's proposals, including Service Integration Plans, capacity to support the Operating Plan, service guarantees, open gateways, and labor conditions. However, the tone of CSX's comments is directly contradicted by the extreme nature of its proposed regulatory language, much of which has the feel of a bill of attainder designed to prevent the BNSF/CN combination.

First, in its Appendix A, CSX proposed a definition of "transcontinental transaction," to facilitate its effort to propose regulations that would only apply to such mergers. The

Board's regulations should not draw such distinctions, but should be applicable to all mergers.

Second, in Appendix B, CSX proposed a regulation that would enable the Board, at any time, "due to temporary conditions in the industry or other similar factors," to dismiss an application after concluding that it would not be in the public interest to *consider* or approve the application at such time. This issue is being extensively litigated at this time,[19] and BNSF will not repeat that argument except to note this proposal would violate specific provisions of the Board's governing statutes.

Third, in Appendix C, CSX has proposed language that would govern service disputes after implementation of a merger. Its remedies would include binding arbitration, with a termination right for contract shippers (without time limit and without any requirement that any service deficiencies be related to merger implementation). CSX also has proposed language that could override any paper barriers with shortlines. While the Board should consider the adequacy of service guarantees and remedies in determining whether a proposed merger is in the public interest, BNSF believes that the Board should not prescribe the details of such guarantees and remedies, but instead should leave that to negotiation among the interested parties. Merging railroads will have strong incentives to develop acceptable structures, so that they can avoid concerted shipper opposition to their merger.

Fourth, in Appendix D, CSX proposed regulatory language that would require cross-border transactions to include a full description of the operations of the combined railroads

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[19] *Western Coal Traffic League, et al. v. Surface Transportation Board*, Nos. 00-1115, 00-1118 and 00-1120 (consolidated).

outside of the U.S. and that would require environmental review by the Board of any potentially significant effects outside of the United States. The proposed regulation also would require information on how the laws of the foreign country would affect operations in the U.S., rail supply, the potential for regulatory conflicts and Board review, with public participation, of any conditions imposed by the foreign country in its review of the merger application. CSX also proposed language that would enable the Board to reject the proposed BNSF/CN combination solely because of the Canadian requirement, imposed as part of the privatization of CN, that CN remain headquartered in Canada and have a majority of Canadian citizens on its Board of Directors. CSX has not – and could not – show why these minor restrictions, particularly applied to a combined railroad that will be majority owned by U.S. citizens and conduct most of its operations in the U.S., prevent a merger from being in the public interest.

In Appendix E, CSX proposed detailed language to govern the contents of any Service Integration Plan. While BNSF agrees that any merger application should contain such a plan, the contents of the plan should be tailored to the specific circumstances of each merger. For example, the end-to-end combination of BNSF and CN, with each operating company retaining its separate identity, will not raise the same service or integration issues that the CSX and NS division of Conrail assets did.

In Appendix F, CSX proposed that each application contain a list of all shortlines, require pre-filing consultation with all such shortlines prior to the filing of the application, and provide a copy of the operating plan, etc. to each shortline. This proposed regulation is unnecessary. BNSF and CN will consult with any shortline that will be directly affected by their proposed combination, but there is no need to require the two carriers to consult with every shortline with which they interconnect. Furthermore, any interested shortline may intervene in the BNSF/CN proceeding, as many have, and receive the same documentation as any other party.

In Appendix G, CSX proposed that any transcontinental transaction application include a discussion of the impact on all rail carriers and competition of any additional transcontinental transactions that are proposed or reasonably likely to be proposed in response. Of course, BNSF and CN cannot forecast what actions other carriers might take in response to their transaction, and the analysis of all possible responses is an impossible burden.

In Appendix H, CSX proposed a general policy statement on review of mergers. The policy statement would require a merger application to demonstrate that the merger will produce substantial benefits to shippers in the U.S., which benefits are not overshadowed by detriments, including a substantial reduction in transportation alternatives. However, the Board's analysis of public benefits should extend beyond benefits to shippers and include other benefits, such as environmental benefits and increased efficiency in the use of the Nation's resources. CSX also has proposed that the Board consider in any case involving a transcontinental transaction "the impact of potential or reasonable hypothetical combinations or transactions on the consolidation . under consideration." As discussed more fully above, the Board should only consider *real* transactions that are firmly announced in time to be considered along with any previously announced transactions.

Norfolk Southern Corporation and Norfolk Southern Railway Company ("NS"). NS also proposed significant revisions to the Board's merger regulations and its approach to mergers. First, NS proposed that the STB raise the bar to future mergers and only approve new mergers if the applicants can "persuasively demonstrate" that the proposed transaction will generate net public benefits that are "tangible, significant and likely." While it is not clear what NS's formulation actually means when compared to the Board's current standard of review, BNSF would object to any proposal that changes the existing burden of proof, except in those areas of service addressed by BNSF in its initial comments.

Second, NS suggested that the Board amend its regulations to exclude from its public interest analysis any claimed synergies or other benefits that could reasonably be achieved without a formal merger or consolidation. This proposal is misguided. The relative benefits of mergers and alliances are subject to debate, and NS's test would result in others attempting to substitute their judgment for the reasonable business judgment of the applicants. For example, in weighing the benefits from an alliance, the Board would have to decide what estimate of time limits or longevity should be factored into an analysis of the benefits accruing to involved railroads, shippers and the public from voluntary, terminable alliances. The benefits of alliances are speculative and subject to well-known limitations, as NS acknowledged in the Verified Statement of James W. McClellan. Furthermore, NS's bias towards alliances is based on its view that the Board should maintain the "balanced structure" of the rail industry, a position that attempts to freeze competition. Finally, NS' suggestion that the "least restrictive alternatives" test is appropriate because antitrust agencies use it when reviewing *an otherwise anticompetitive merger* is inapt, because the Board is committed to maintaining competitive options for shippers who will be affected by a proposed combination.

NS also proposed that service improvements should be a primary factor in the Board's public interest determination. BNSF agrees with this general principle, and it has made specific proposals that would enable shippers, the public and the Board to assess and weigh its plans to achieve service goals. However, BNSF objects to NS' proposal that achievable efficiencies somehow be afforded less weight than structural changes.

NS recommended that the Board require merger applicants to file a Service Integration Plan, a step to which BNSF and CN have already agreed in their combination and which BNSF also proposed as a change in the Board's regulations. BNSF also agrees with NS that the nature of any remedies for service deficiencies is best left to the private negotiation of the parties. NS proposed that any merger application include a capital or infrastructure investment plan. BNSF believes that this analysis should be part of the Operating Plan and the Service Integration Plan, rather than separated into a stand-alone report.

The Kansas City Southern Railway Company ("KCS"). In the guise of a series of "modest proposals," KCS proposed major changes in the Board's merger policies, changes that would benefit KCS but only by exacting a significant toll on other carriers and the industry as a whole

First, KCS suggested that the Board amend its regulations to require that mergers preserve all existing rail options. In essence, KCS has requested that the Board reverse its current policy and establish a presumption that 4-to3 and 3-to-2 situations result in competitive harm to shippers. KCS's position is based, in part, on the view that the Board should discourage the development of transcontinental railroads and the assertion that the benefits of mergers can be achieved through other means.

BNSF has addressed these issues in detail above and in its initial comments. The Board should not establish any presumption against future mergers or assume that benefits can be achieved through hypothetical and untested alliances. With respect to 3-to-2 shippers, the Board has addressed this issue extensively in recent years, and, particularly given the limited number of 3-to-2 shippers, the Board's current policy of reviewing any specific competitive concerns raised by 3-to-2 shippers should be maintained.

Second, KCS proposed that any service restrictions contained in marketing, haulage and trackage rights agreements should be disclosed and justified. KCS proposed that any such restrictions be modified or removed by the Board if it would enhance competition or improve service to shippers.

The Board should reject this proposal. In prior mergers, the Board has imposed or accepted a varie of agreements designed to maintain competition for shippers, as well as private agreements designed to remove objections to mergers. These conditions were heavily negotiated and carefully reviewed by the Board. There is no basis for revising those conditions unless revisions are necessary and appropriate to offset any reduction in service for 2-to-1 shippers

Third, KCS proposed that merger applicants must document all benefits claimed in prior mergers and demonstrate that all such benefits will be maintained. In short, KCS is concerned that future mergers may adversely affect agreements it has reached with merging carriers in prior proceedings. However, rather than creating a new requirement for all merger applicants, the Board should invite any affected party to demonstrate that its interests will be harmed in a *cognizable* manner. However, the Board must be careful, in assessing such claims by KCS and other carriers, to distinguish between the protection of the complaining carrier and the preservation of competition.

Fourth, KCS suggested that the Board amend its regulations to require the disclosure of any settlement agreements and a discussion of the effect of that settlement on the proposed transaction. KCS also would create a 30-day period for discovery and the filing of evidence on such settlements.

The Board should reject this proposal. It would strongly discourage settlements, by increasing the transaction costs for settling shippers and by imposing delay on merger applicants as a price of reaching settlements with affected parties. Furthermore, there is no valid reason for disclosing the commercial terms of bilateral agreements between a carrier and its shippers.

Fifth, KCS requested that the Board establish a presumption that any station, facility or terminal that was closed to reciprocal switching in the 24 months prior to filing of a notice of intent should be reopened as a condition to the merger. BNSF agrees that such a concept is worthy of serious consideration, possibly by establishing a presumption that such stations would be reopened to reciprocal switching, absent a showing that such action is not necessary or contrary to the public interest.

Sixth, KCS proposed that the Board amend its regulations so that (i) any merger by a Class I railroad with KCS to which KCS consented would not be considered a major transaction by the Board, and (ii) any merger by a Class I railroad with KCS to which KCS objected would be treated as a major transaction. The proposal would drive an unwarranted wedge into the well-established definition of Class I railroads. KCS has offered no valid justification why it should be treated as a "Class I railroad" for some, but not all, purposes.

Finally, KCS proposed that merger applicants be required to disclose and justify any paper and steel barriers in any agreement between Class II and Class III carriers who interconnect with the merger applicants. Upon request, the Board would review such restrictions and modify or eliminate them "where the public interest requires." The infirmity of KCS' proposal is revealed by the fact that the Board's review would apparently not be tied in any way to the effects of the proposed merger. Ironically, KCS' proposal follows its own spin-off of a shortline, the Meridian Southern Railway, L.L.C., operating on former KCS trackage between Meridian and Waynesboro, Mississippi, subject to a new paper barrier at Meridian. Thus, KCS is establishing new shortlines and paper barriers at the same time that it opposes similar actions by other carriers.

D. Shortline Railroads

The American Short Line and Regional Railroad Association (ASLRRA): ASLRRA urged the Board to adopt a "Bill of Rights" for Short Line and Regional Railroads. Specifically, ASLRRA proposed that the Board impose four conditions on mergers that would guarantee shortline and regional railroads the right to: (1) compensation for merger-related service failures; (2) interchange and routing freedom; (3) competitive and nondiscriminatory rates and pricing; and (4) fair and nondiscriminatory car supply. ASLRRA also argued that the Board should require applicants to address any proposed transaction's effect on connecting shortline and regional railroads.

As noted in BNSF's initial comments, the issues raised by the ASLRRA's proposed "Bill of Rights" generally extend beyond the direct effects of specific merger proposals and propose instead a general restructuring of the relationship between Class I carriers and shortlines These broader concerns should be addressed, if at all, on a national basis, with any outcome applied to all Class I railroads. With respect to compensation for merger-related service problems, BNSF has noted above that compensation and service alternatives should be provided to *shippers*, not to other carriers.

Farmrail System, Inc. ("Farmrail"). Farmrail, a shortline railroad, presented regulatory proposals that are typical of shortline issues.

First, Farmrail proposed that the Board amend its regulations to provide that shortline railroads will generally be treated as shippers and not as competitors of merger applicants. BNSF believes that railroads owe obligations to the *shippers* to which they provide common carrier or contract services, not to connecting carriers that also provide service to those shippers.

Second, Farmrail proposed several changes designed to enhance the position of shortline railroads, including (i) the elimination of all paper barriers for all new traffic, with all existing barriers to expire after they have been in place for seven years; (ii) the grant to shortlines of haulage or trackage rights to another Class I carrier located within 100 miles; (iii) the grant to shortlines of the right to make rates for new interline business; and (iv) the provision of damages, including lost revenues and increased car hire, that result from service failures.

Items (i), (ii) and (iii), as noted in BNSF's initial comments, have nothing to do with mergers. General issues involving shortlines or open access should be considered and resolved on a national basis, not as a condition to mergers. Issues relating to specific contracts between Class I railroads and tributary shortlines, including contractual obligations for deferred compensation, marketing arrangements, paper barriers, car supply and other issues, should be left to case-by-case discussion between the contracting parties.

CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Reply Comments are being served on all parties of record this 5th day of June, 2000.

David I. Bloom